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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission
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WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA ELECTRIC POWER COOPERATIVE, INC. FOR VARIOUS AUTHORIZATIONS ASSOCIATED WITH ITS RESTRUCTURING

DOCKET NO. E-01773-A-00-0826

RESPONSE TO AEPCO'S EXCEPTIONS

The Arizona Corporation Commission staff ("Staff") hereby responds to the exceptions filed by the Arizona Electric Power Cooperative ("AEPCO") on July 18, 2001. Staff does not usually respond to exceptions; however, we believe that additional staff comments may assist the Commission in expeditiously deciding this matter. Staff agrees with some of AEPCO's exceptions, disagrees with some, and is neutral as to others.

I. Ministerial Corrections

AEPCO suggests a number of changes that it describes as ministerial, i.e., "not intended substantively to change the Proposed Opinion." AEPCO's Exceptions at 2. Staff believes that one of these changes affects the accuracy of the proposed order and is better left as it is.

AEPCO proposes striking the following sentence from p. 6, lines 19-21: "[t]he purpose of this restriction is to ensure that AEPCO and Southwest's margins are not appropriated by Sierra compromising their ability to make timely debt payments to RUS." AEPCO's Exceptions, Ex. A. Staff took this sentence from statements made by AEPCO in its application to FERC. See Exhibit A. Although Staff did not quote AEPCO's FERC application, the sentence in the proposed order is nonetheless very close to the statement made by AEPCO. Because Staff's proposed order virtually quotes AEPCO's own language, it is unreasonable for AEPCO to allege that this sentence contains an error. AEPCO's proposed revision appears to soften the message; nonetheless, Staff sees no reason why AEPCO should be allowed to retreat from its own statements.

Staff accepts the remainder of AEPCO's ministerial corrections.

II. Rate Findings Amendment

AEPCO suggests adding a finding of fact that sets forth the company's fair value rate base and associated rate of return as well as the company's generation related rate base and associated rate of return. Staff has no objection to including these findings, but questions whether they are necessary. AEPCO claims that its application is not seeking a change in its revenue requirement. If there is no overall rate change, then a fair value finding is not necessary. In fact, the Commission commonly approves transfers of plant and CC&Ns without fair value findings, as long as the rates stay the same.

Nonetheless, Staff does not oppose the finding proposed by AEPCO. Staff suggests, however, that AEPCO's proposal is incomplete, because it specifies generation rate base but does not specify transmission rate base. AEPCO has acknowledged that the Commission presently approves AEPCO's transmission rates, and has claimed that the restructuring will not affect the Commission's jurisdiction. If a fair value finding is necessary, it should also address transmission assets.

III. Rate Case

Staff has recommended that the Commission order AEPCO to file a rate case within eighteen months of a final order in this case. The rate case would allow the Commission to ensure that the assets have been appropriately allocated among the three resulting entities, to examine the costs and benefits of the restructuring, and to ensure that AEPCO continues to charge just and reasonable rates. AEPCO opposes this requirement.

First, AEPCO assures the Commission that "[a]ssets and liabilities are being carefully assigned and allocated among each entity in the manner described in the Application and pursuant to independent appraisal . . . ." AEPCO's Exceptions at 3. AEPCO essentially asks the Commission to trust its judgment. Doubtless, AEPCO believes that its allocations and valuations are correct. This does not mean, however, that the Commission would necessarily agree. Disagreements over these sorts of allocations and valuations are not uncommon in regulation. Furthermore, these determinations serve as the basis of ratemaking, and it is reasonable for the Commission to promptly review them to ensure their accuracy.

AEPCO has filed this restructuring without providing a cost of service study, which would have allowed Staff to evaluate the propriety of these allocations. Staff does not believe that this omission should prevent the Commission from approving AEPCO's application; nonetheless, the Commission should review those allocations within a reasonable time.

AEPCO also argues that the objective of the restructuring has never been cost savings. But this contradicts information provided to Staff in support of the application, in which organizational, operational, financial, and marketing efficiencies were cited as reasons in its favor. See Exhibit B. And even if AEPCO is unconcerned about cost savings, that does not mean that this subject is irrelevant to the Commission.

The Commission should evaluate this application to ensure that it serves the public interest, not merely the convenience of AEPCO's management. In fact, in light of AEPCO's statements that it does not anticipate cost savings, the Commission should insist upon a cost/benefit analysis in a rate case to ensure that costs are not increasing. AEPCO states that the restructuring does not change anything: "[t]he day after close the same assets supported by the same debt administered by the same employees serving the same customers will exist as the day before close." AEPCO's Exceptions at 3. This statement overlooks the fact that the restructuring will create three organizations where previously there was one. This raises the potential for duplicative administrative and organizational costs. Even if cost savings are not AEPCO's objective in restructuring, the Commission should at least ensure that the restructuring is not leading to unreasonable cost increases.

Finally, AEPCO contends that its rates have been reduced twenty-two percent over the last fifteen years. But some of the supposed rate reductions are comprised of expired surcharges or purchased power refunds. Although these events may result in a perceived decrease in customer bills, they are not true rate reductions. By contrast, although AEPCO's 1993 rate case resulted in a rate reduction, those rates were specifically designed to hold revenues constant. Accordingly, although rates may have decreased, customer bills were intended to stay the same. See Exhibit C. Although Exhibit D to AEPCO's Exceptions summarizes certain numerical adjustments to AEPCO's rates, it does not necessarily mean that customers have seen a twenty-two percent reduction in their bills.

AEPCO has not had a rate case since 1993. It is important for the Commission to have a chance to examine AEPCO's operations, both to ensure that assets have been properly allocated and to ensure that rates continue to reflect the underlying costs.

IV. Code of Conduct

AEPCO has asked that the code of conduct proceeding be addressed outside of a rate case. Staff believes that addressing code of conduct issues within the context of a rate case will be more efficient than requiring two separate proceedings. If, however, the Commission prefers addressing the code of conduct in a separate proceeding, Staff requests that AEPCO be required to file its code of conduct for review within eighteen months of the date of the Commission's order approving the restructuring.

V. Conclusion

Staff requests that the Commission adopt the proposed order filed by Staff on July 13, 2001.

RESPECTFULLY SUBMITTED this 20th ,day of July, 2001

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Sierra Southwest Cooperative Services, Inc.	)	Docket No. ER01-____-000

APPLICATION FOR ACCEPTANCE OF MARKET-BASED AND OTHER RATES

Sierra Southwest Cooperative Services, Inc.	)	Docket No. EL01-____-000

REQUEST FOR DECLARATORY ORDER
DISCLAIMING JURISDICTION AS TO CERTAIN ACTIVITIES

Southwest Transmission Electric Power Cooperative, Inc.	)	Docket No. NJ01-____-000

OPEN ACCESS TRANSMISSION TARIFF AND OASIS STANDARDS OF CONDUCT

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TRANSCO's debt and thus provide "security" to the RUS. The effect is to deny the Class A Members the flexibility that they would enjoy under the OATT.

The third category involves various limitations on Sierra's activities with respect to GENCO and TRANSCO. These restrictions help assure that control over the activities of GENCO and TRANSCO remains with those entities and does not pass to Sierra, an entity over which RUS has no oversight because its assets are not subject to an RUS mortgage. These restrictions also prevent Sierra from appropriating any margins that might be earned by GENCO or TRANSCO, so that those margins can be available to help satisfy GENCO's and TRANSCO's financial obligations to the RUS and other creditors.

4. Documents Governing the Restructuring

The terms and conditions of the Restructuring are specified in a number of documents. The more relevant documents have been included as attachments to this filing.[38]

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[38]As noted further infra, these documents are submitted for informational purposes only, unless the Commission should decide that they should be subject to § 205 of the Federal Power Act.

Attachment 16 contains definitions that are used in more than one of the Restructuring documents. One document that is not being submitted is the Member Agreement, which essentially obligates GENCO, TRANSCO, Sierra, and the Class A Members to enter into the other agreements that effectuate the Restructuring. The document adds relatively little to the other agreements, but it will be provided to the Commission upon request.

B

CONCEPTUAL RECOMMENDATIONS: ARIZONA ELECTRIC POWER COOPERATIVE, INC. RESTRUCTURING AND REVISION OF WHOLESALE POWER SALES RELATIONSHIPS

AEPCO STRUCTURE/WHOLESALE POWER CONTRACT STUDY COMMITTEE

INTRODUCTION

These Recommendations for Arizona Electric Power Cooperative, Inc. Restructuring and Revision of its Wholesale Power Sales Relationships ("Recommendations") are conceptual in nature, and represent the consensus reached by the AEPCO Structure/Wholesale Power Contract Study Committee ("Study Committee") with respect to the ultimate structure of Arizona Electric Power Cooperative, Inc., ("AEPCO"), its revised wholesale power sales relationships with each Class A Member Distribution Cooperative ("Member") and the nature and extent of the retail sales activities of the restructured companies. The purpose of this presentation is to detail the basic structure, resulting contractual arrangements, and most efficient scope of retail sales activities recommended by the Study Committee to the Board of Directors of AEPCO and its Members for further consideration. The Board of Directors of AEPCO accepted these recommendations on September 10, 1997.

The Study Committee has identified the need to adopt these recommendations to:

a) increase competitiveness of the restructured AEPCO and its Members;
b) create additional organizational, operational, financial and marketing efficiencies;
c) make available more flexible power purchase arrangements to the Members;
d) diminish regulatory burdens;
e) comply fully with Federal Energy Regulatory Commission Open Access Orders;
f) facilitate acquisition of new customers and members of whatever nature for both the restructured AEPCO and its Members;
g) focus employee attention on specific areas of responsibility;
h) strengthen relationships with Members;
i) streamline decision making;

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